

Decision No. 92719 FEB 18 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of SAN JOSE WATER WORKS, a)
corporation, for an order)
authorizing it to increase rates)
charged for water service.)

Application No. 59819
(Filed July 17, 1980)

McCutchen, Doyle, Brown & Enersen, by A. Crawford
Greene, Attorney at Law, for applicant.
Alvin S. Pak, Attorney at Law, and Thomas T.
Hamamoto, for the Commission staff.

O P I N I O N

Applicant San Jose Water Works (San Jose) requests authority to increase water rates by \$4,248,300 or 13.05 percent in test year 1981 and by additional amounts of \$1,374,800 or 3.67 percent in 1982 and \$1,374,800 or 3.59 percent in 1983. San Jose requests rates which are designed to produce a rate of return on rate base of 10.78 percent in 1981, 10.91 percent in 1982, and 11.04 percent in 1983. These rates of return are estimated to provide a constant return on common equity of 15 percent in each of the three years.

San Jose supplies water to approximately 189,000 commercial and industrial customers in a service area in and about San Jose, Los Gatos, Monte Sereno, Saratoga, Campbell, Cupertino, and Santa Clara, all in Santa Clara County. On May 9, 1980 Campbell Water Company was merged into San Jose and on August 19, 1980 the Commission authorized the acquisition of San Jose Highlands Water Company.

After due notice, hearing in this matter was held before Administrative Law Judge K. Tomita in San Francisco on November 20, 1980 and submitted on the same day. No customers appeared at the hearing to complain about service or rates.

This application was filed pursuant to the Regulatory Lag Plan for water utilities. Under this procedure an informal public meeting was held on September 10, 1980 at the San Jose City Health Department Building. The customers of San Jose were notified of the meeting by a notice inserted with the monthly bills. Only four customers attended the meeting. One customer praised San Jose and the quality of water provided. One customer expressed concern about billing procedures when a meter is not read and the other customers expressed concern about how the increase may possibly affect their bills.

Need for Rate Increase

In its application San Jose states that it needs an increase in rates since the annual increase in revenues resulting from customer growth or increased consumption per metered customer is more than offset by increases in expenses and rate base. The revenue increase requested not only covers increases in expenses but also changes in water use, rate base, and cost of money. San Jose states that the 10.78 percent, 10.91 percent, and 11.04 percent rates of return on rate base it is seeking for 1981, 1982, and 1983, respectively, includes a 15 percent return on common stock equity in each of the three years. San Jose considers these return on rate base as the minimum rates of return necessary to enable it to maintain its credit standing, attract new capital at a reasonable cost, and provide a fair and reasonable return on common equity.

J. W. Weinhardt, president and chief executive officer of San Jose, testified on results of operations, rates, and conservation and Fred R. Meyer, chief financial officer and treasurer, testified on rate of return. For the Commission staff Thomas T. Hamamoto, senior utilities engineer, Jerry H. Shiu, associate utilities engineer, and Brian Chang, associate utilities engineer in the Revenue Requirements Division, testified on the results of operations report, and Mrs. Dana Gardner, research analyst II in the Revenue Requirements Division, testified on cost of capital and rate of return.

TABLE 1

SAN JOSE WATER WORKS
Summary of Earnings
Estimated Years 1981 and 1982
(Dollars in Thousands)

	<u>1981</u>		<u>1982</u>		<u>Adopted</u>	
	<u>Staff</u>	<u>Utility</u>	<u>Staff</u>	<u>Utility</u>	<u>1981</u>	<u>1982</u>
	<u>At Present Rates</u>					
Op. Rev.	\$32,953.4	\$32,558.6	\$33,581.3	\$33,093.9	\$32,953.4	\$33,581.3
Op. Exp.						
Op. & Mtnc.	16,521.2	16,336.6	17,347.8	17,135.0	16,521.2	17,347.8
A & G	2,525.9	2,522.1	2,752.2	2,747.0	2,525.9	2,752.2
Deprec.	3,108.1	3,089.0	3,274.1	3,235.8	3,108.1	3,274.1
Taxes - Other	1,701.8	1,692.1	1,852.5	1,828.3	1,701.8	1,852.5
State Corp. F. T.	506.2	465.5	428.7	368.2	506.2	428.7
Fed. Inc. Tax	<u>1,561.4</u>	<u>1,418.3</u>	<u>1,204.3</u>	<u>966.4</u>	<u>1,561.4</u>	<u>1,204.3</u>
Total Op. Exp.	25,924.6	25,523.6	26,859.6	26,280.7	25,924.6	26,859.6
Net Op. Rev.	7,028.8	7,035.0	6,721.7	6,813.2	7,028.8	6,721.7
Rate Base	83,983.9	84,393.0	87,261.2	87,786.6	83,983.9	87,261.2
Rate of Return	8.37%	8.34%	7.70%	7.76%	8.37%	7.70%
	<u>At Proposed Rates</u>				<u>Adopted Rates</u>	
Op. Rev.	37,252.7	36,806.9	39,359.2	38,787.5	35,807.5	37,858.9
Op. Exp.						
Op. & Mtnc.	16,532.7	16,348.0	17,363.2	17,150.2	16,528.8	17,359.2
A & G	2,537.8	2,533.9	2,768.1	2,762.8	2,533.8	2,764.0
Deprec.	3,108.1	3,089.0	3,274.1	3,235.8	3,108.1	3,274.1
Taxes - Other	1,701.8	1,692.1	1,852.5	1,828.3	1,701.8	1,852.5
State Corp. F. T.	916.7	871.2	980.4	911.8	778.7	837.1
Fed. Inc. Tax	<u>3,339.5</u>	<u>3,175.3</u>	<u>3,593.9</u>	<u>3,321.2</u>	<u>2,741.8</u>	<u>2,973.4</u>
Total Op. Exp.	28,136.6	27,709.5	29,832.2	29,210.1	27,393.0	29,060.3
Net Op. Rev.	9,116.1	9,097.4	9,527.0	9,577.4	8,414.5	8,798.6
Rate Base	83,983.9	84,393.0	87,261.2	87,786.6	83,983.9	87,261.2
Rate of Return	10.85%	10.78%	10.92%	10.91%	10.02%	10.08%
Times Interest Coverage After Income Taxes					2.8X	2.77X

Results of Operations

Table 1 compares the summary of earnings estimates of San Jose and the staff for estimated years 1981 and 1982 at present and proposed rates together with the adopted summary of earnings for 1981. In order to have a common basis of comparison with San Jose's presentation, the staff used rates in effect on April 2, 1980 as present rates. Since April 2, 1980 the following changes in rates have been authorized by advice letters:

SAN JOSE AREA

<u>Advice Letter No.</u>	<u>Effective Date</u>	<u>Amount</u>	<u>Reason</u>
151	6-3-80	\$ 698,000	Purchased Power
153	7-15-80	\$1,155,800	Purchased Water and Pump Tax

CAMPBELL SERVICE AREA

54	5-20-80	\$ 33,635	Purchased Power
155	7-15-80	\$ 33,400	Purchased Water and Pump Tax

At the November 20, 1980 hearing, Weinhardt testified that San Jose had carefully reviewed the staff results of operations report. San Jose then updated its own showing to reflect more current recorded information and found that the figures were in substantial agreement with the staff results for 1981. He concluded that the staff estimates were a fair and accurate appraisal of what test year 1981 will be under normal weather conditions.

The staff estimates for revenues exceeded San Jose's estimates for 1981 because of its higher estimate of number of customers. This was largely offset by higher staff estimates for ground water extraction charges, purchased power, and an allowance of \$50,000 per year for three years to make necessary repairs and maintenance in the

San Jose Highlands service area. For the purposes of this proceeding we will adopt the staff estimates of results of operations for test years 1981 and 1982, since they were based on more recent information and San Jose agrees they are reasonable. Expenditures made out of the \$50,000 allowance per year for repairs and maintenance to the San Jose Highlands service area shall not be capitalized.

Appendix C of this decision shows the adopted quantities and tax calculations which should be used to facilitate future filing of requests for offset rate relief.

Rate of Return

Mr. Meyer, San Jose's chief financial officer, also testified that he had thoroughly reviewed the staff's cost of capital and rate of return report and generally agreed with staff witness Gardner's figures and analysis except for her recommended return on common equity. Therefore, the only significant issue in this proceeding is the appropriate return on common equity to be used in determining the reasonable rate of return San Jose should be allowed to earn on its rate base.

Meyer testified that the 13.2 percent return on common equity recommended by the staff witness as well as the 15 percent return on common equity requested by San Jose is too low when compared to (a) the prime rate of 16½ percent as of the date of the hearing, (b) U.S. Treasury bonds maturing in 1994 selling to yield 13.39 percent, and (c) six month T-Bill accounts at insured savings and loans yielding 14.14 percent. He further testified that Southern California Water Company, which was recently authorized to earn 13.4 percent return on common equity, had to sell 550,000 shares of common stock at \$12 per share which reduced book value per share from \$16.95 to \$15.35. Meyer testified that this meant that investors were discounting the authorized rate of return on common equity of 13.40 percent by 22 percent to a real rate of return of 17 percent.

Staff witness Gardner testified that in arriving at her 13.2 percent recommended return on common equity she considered San Jose's past earnings performance with other water utilities, interest

coverage requirements, capital structure, financing needs, and the fact that step rates are being requested in this proceeding. The staff recommended rates of return for average years 1981, 1982, and 1983 are as follows:

	<u>Capital Ratios</u>	<u>Effective Rate</u>	<u>Weighted Cost</u>
Average Year 1981			
Long-Term Debt	48.50%	7.37	3.57%
Preferred Stock	6.50	7.01	.46
Common Stock Equity	<u>45.00</u>	13.20	<u>5.94</u>
Total	100.00%		9.97%
Average Year 1982			
Long-Term Debt	48.50%	7.50	3.64%
Preferred Stock	6.50	6.98	.45
Common Stock Equity	<u>45.00</u>	13.20	<u>5.94</u>
Total	100.00%		10.03%
Average Year 1983			
Long-Term Debt	48.50%	7.72	3.74%
Preferred Stock	6.50	6.96	.45
Common Stock Equity	<u>45.00</u>	13.20	<u>5.94</u>
Total	100.00%		10.13%

The staff-recommended rates of return are based on average year capital ratios and costs and include a 13.20 percent allowance for common stock equity. It also includes an allowance for additional debt anticipated to be issued in each of the three years.

We are of the opinion that the staff estimates of capital ratios and cost of long-term debt and preferred stock are reasonable. However, we are of the opinion that the return on common stock equity should be increased to 13.30 percent rather than the 13.20 percent recommended by the staff. The effect of our adopted higher return on common equity is to increase the weighted cost of common equity by .05 percent over the staff-recommended rates of return

resulting in rates of return on rate base for average year 1981, 1982, and 1983 of 10.02 percent, 10.08 percent, 10.18 percent, respectively. Our adopted rate of return should enable San Jose to have sufficient earnings to meet its long-term debt and preferred stock obligations and also allow for moderate growth in retained earnings after payments of reasonable dividends. Our adopted rates of return strike a balance in enabling consumers to obtain reasonable service at the lowest possible rates while allowing San Jose to attract necessary capital at reasonable rates to enable it to continue providing good water service.

Step Rates

San Jose proposes the adoption of step rates because labor, material costs, plant investment, depreciation, and taxes have generally increased on a per customer basis resulting in San Jose's experiencing an annual decline in rates of return which it expects will continue in the future. San Jose is seeking step rates for the years 1981 through 1982 based on its estimated earnings for the 1981 and 1982 test years at the rates of return requested, and for 1983 a third step based on the average annual operational attrition for the period 1980 through 1982 at proposed 1982 rates to determine the 1983 revenue level on a 1982 test year.

The staff recommends that the operational attrition allowance for 1983 be based on the results of operation for test years 1981 and 1982 at present rates rather than at proposed rates as suggested by San Jose. We will adopt the staff recommendation to be consistent with our prior decisions adopting step rates for other water utilities.

Authorized Revenue Increases

As shown in Table 1 our adopted results will provide for an increase in revenues of \$2,854,100 or 8.7 percent over revenues at present rates for test year 1981. Rates for test year 1982 will

yield additional gross revenues of \$2,051,400 which represent a 5.7 percent increase over revenues at 1981 adopted rates. In addition, a third set of rates will be authorized to allow for attrition in rate of return after test year 1982. The third step provides for a 1983 operational attrition allowance of .67 percent and a financial attrition allowance of .10 percent or a combined total of .77 percent on rate base. We will authorize step increases for 1982 and 1983 in keeping with our intention that Class A water utilities will not file a general rate increase application more often than once every three years. Moreover, we will require San Jose to file an advice letter with supporting workpapers to justify the step increases for 1982 and 1983.

Rate Design

San Jose requests that the general metered rates tariff schedules for customers formerly served by the Campbell Water Company be combined so that all general metered customers will be charged the same rates. Since rates have increased over 25 percent since the lifeline rates were established, San Jose proposes that lifeline rates be increased by the average percentage revenue increase for 1981, 1982, and 1983. San Jose also proposes that the fire protection surcharge be folded into the service charge component and that Schedule No. 6, Resale Service, be eliminated and such service be billed under general meter service rates. No increases are proposed for any other present tariff schedules. San Jose also proposes to reduce the quantity applicable to the first tier quantity rates from the first 500 cubic feet to the first 300 cubic feet. This is in line with the lifeline quantity adopted for most other water utilities.

The staff concurs with most of San Jose's rate design proposals and also further recommends that the Commission:

- a. Consolidate Schedules Nos. 4 and 4c in one Schedule No. 4, Private Fire Protection Service. The net effect will be that those customers served under former Campbell Schedule No. 4c will experience an average increase of approximately 24 percent.
- b. Continue maintaining Tariff Schedule No. 5 for Public Fire Hydrant Service.
- c. Retain present Schedule No. 6, Resale Service.
- d. Service charges for 3/4-inch and 1-inch meters be rounded to the nearest 10 cents and for meters larger than 1-inch rounded to the nearest dollar.

The staff concurs with San Jose's proposal to fold the existing fire protection surcharge for general metered service into the service charge component on a monthly per meter basis provided that San Jose makes a showing that it has taken all necessary action to maintain the levels of fire protection service required by General Order No. 103 and that San Jose has undertaken reasonable efforts to continue, renew, or make contractual agreements with applicable fire protection agencies pursuant to Resolution No. L-213. Staff elicited such testimony from San Jose's witness.

San Jose had no objections to the staff rate design proposals except for the retention of Schedule No. 6, Resale Service, unless such schedule was increased by the percentage increase authorized in this proceeding. We find San Jose's rate design proposals, as modified by the staff, reasonable and will adopt such modified rate design proposals. In ordering the retention of Schedule No. 6, Resale Service, we will require that such tariff schedule be increased by the percentage increase authorized in this decision.

The rates shown in Appendix A of this decision are based on the sum of the revenue requirement adopted plus the sum of the authorized amounts requested in the Advice Letters discussed previously in this decision.

Wage Price Standards

By Resolution No. M-4704 dated January 30, 1979 the Commission ordered all utilities requesting general rate increases to submit an exhibit to show whether the requested increase complies with the Voluntary Wage and Price Standards issued by the Council on Wage and Price Stability (COWPS). San Jose submitted late-filed Exhibit 10 on December 9, 1980 pursuant to the Administrative Law Judge's request. Exhibit 10 shows that the wage increases used and the requested rate increases are within the established guidelines. The staff takes no exception to the information contained in Exhibit 10; therefore, the record in this proceeding will be reopened to receive Exhibit 10 into evidence.

Conservation Program

San Jose presented Exhibit 4 setting forth its continued water conservation program which is coordinated with the Santa Clara Valley Water District and the State Department of Water Resources. The San Jose area will be one of three test areas in California in which the State will be distributing water saving kits to all residents. San Jose has indicated that it will cooperate and aid the State in this program in whatever ways would be most effective.

The staff in its report indicates that San Jose's pump testing program to achieve electrical energy conservation was adequate. The staff's examination of San Jose's records did not reveal pump facilities operating at low efficiency.

Working Cash

Although the staff found some discrepancies in San Jose's lead-lag analysis to estimate working cash allowance, it accepted San Jose's figures since the net effect on rate of return was negligible. The staff recommends that San Jose prepare a new lead-lag study for its next general rate increase application.

Findings of Fact

1. The adopted estimates previously discussed herein (as set forth in Table 1) of operating revenues, expenses, and rate base for test years 1981 and 1982 reasonably indicate the results of operations for the two test years.

2. A 0.67 percent attrition in the rates of return for test years 1981 and 1982 at present rates represents a reasonable estimate of the operational attrition to be expected in 1983.

3. Rates of return of 10.02 percent, 10.08 percent, and 10.18 percent, respectively, on the adopted rate base for 1981, 1982, and 1983 are reasonable. The related return on common equity for each year is 13.30 percent.

4. In addition to the operational attrition allowance of 0.67 percent found reasonable in Finding 2, San Jose should be allowed an additional 0.10 percent attrition allowance to cover the estimated financial attrition to be experienced in 1983 or a combined attrition allowance of .77 percent in developing the step rate for 1983.

5. The adopted rates of return are reasonable in that they balance the interest of the ratepayers while providing a reasonable rate of return to investors.

6. The rates authorized herein and set forth in Appendix A will provide revenue increases of \$2,854,100, \$2,051,400, and \$1,383,900 for 1981, 1982, and 1983, respectively, or percentage increases of 8.7, 5.7, and 3.7, respectively, for 1981, 1982, and 1983.

7. San Jose's rate design proposal, as modified by staff recommendations, is reasonable.

8. San Jose's water quality, conservation program, and service are satisfactory.

9. The increases in rates and charges authorized herein are justified and reasonable; and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

10. The further increases authorized in Appendix B should be appropriately modified in the event the rate of return on rate base, adjusted to reflect the rates then in effect together with normal ratemaking adjustments for the 12 months ended September 30, 1981 and/or September 30, 1982, exceeds 10.02 percent and 10.08 percent, respectively.

11. San Jose has taken all necessary actions to provide and maintain levels of fire protection service per requirements of General Order No. 103 and has undertaken all reasonable efforts to continue, renew, or make contractual agreements with applicable fire protection agencies pursuant to Resolution No. L-213; therefore, no refund of fire protection surcharge is necessary.

12. Appendix C provides a comparison of monthly rates as proposed and as adopted, and other information regarding adopted data for this proceeding.

Conclusion of Law

The application should be granted to the extent provided by the following order; the adopted rates are just, reasonable, and nondiscriminatory. The following order should be effective the date of signature since there is a demonstrated need for rate relief.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant San Jose Water Works (San Jose) is authorized to file the rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the new and revised schedules shall be four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date of the revised schedules.

2. On and after November 15, 1981 San Jose is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase in the event that San Jose's rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments, for the twelve months ended September 30, 1981 exceeds 10.02 percent. Such filing shall comply with General Order No. 96-A. The requested step rates shall be reviewed and approved by the Commission prior to becoming effective. The effective date of the revised schedule shall be no earlier than January 1, 1982, or thirty days after the filing of the step rates, whichever is later. The revised schedule shall apply only to service rendered on and after the effective date thereof.

3. On and after November 15, 1982 San Jose is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase in the event that San Jose's rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments, for the twelve months ended September 30, 1982 exceeds 10.08 percent. Such filing shall comply with General Order No. 96-A. The requested step rates shall be reviewed and approved by the Commission prior to becoming effective. The effective

date of the revised schedule shall be no earlier than January 1, 1983, or thirty days after the filing of the step rates, whichever is later. The revised schedule shall apply only to service rendered on and after the effective date thereof.

The effective date of this order is the date hereof.

Dated FEB 18 1981, at San Francisco, California.

I will file a dissent on the issue of the appropriate return on equity.

John E. Bryson

President
Shepherd D. Stouffer

Lawrence J. ...

Commissioners

APPENDIX A
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San Jose Water Works

SCHEDULE NO. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to general metered water service.

TERRITORY

Portions of Campbell, Cupertino, San Jose and Santa Clara, and in Los Gatos, (C) Monte Sereno, and Saratoga and in contiguous territory in the County of Santa Clara.

RATES

<u>Service Charge:</u>	<u>Per Meter Per Month</u>	
For 5/8 x 3/4-inch meter	\$ 2.90	(I)
For 3/4-inch meter	3.70	
For 1-inch meter	4.80	
For 1 1/4-inch meter	7.00	
For 2-inch meter	9.00	
For 3-inch meter	16.00	
For 4-inch meter	22.00	
For 6-inch meter	36.00	
For 8-inch meter	53.00	
For 10-inch meter	65.00	(I)

Quantity Rate:

First 300 cu.ft.	0.395	(I)
Over 300 cu.ft.	0.578	(I)

The service charge applies to all metered service connections, to it is added the charge for water used during the month at quantity rates.

SPECIAL CONDITION

Customers who receive water deliveries for agricultural purposes under this schedule, and who present evidence to the utility that such deliveries qualify for the lower pump tax rates levied by the Santa Clara Valley Water District for agricultural water, shall receive a credit of 9.3 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill.

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San Jose Water Works

SCHEDULE NO. 6

RESALE SERVICE

APPLICABILITY

Applicable to all water service furnished for resale purposes.

TERRITORY

Portions of Campbell, Cupertino, San Jose, and Santa Clara, and in Los Gatos, Monte Sereno, and Saratoga and in contiguous the County of Santa Clara.

RATES

	<u>Per Meter</u>	
	<u>Per Month</u>	
Service Charge:		
For 5/8 x 3/4-inch meter	\$ 2.50	(I)
For 3/4-inch meter	2.80	
For 1-inch meter	3.80	
For 1 1/2 -inch meter	5.00	
For 2-inch meter	7.00	
For 3-inch meter	13.00	
For 4-inch meter	17.00	
For 6-inch meter	28.00	
For 8-inch meter	42.00	
For 10-inch meter	52.00	(I)

Quantity Rate:

Per 100 cu.ft.	0.348	(I)
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The service charge applies to all metered service connections, to it is added the charge for water used during the month at quantity rates.

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San Jose Water Works
AUTHORIZED INCREASE IN RATES
TO SCHEDULE NO. 1

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rates in effect on that date.

	<u>Rates to be Effective</u>	
	<u>1-1-82</u>	<u>1-1-83</u>
Service Charge:		
For 5/8 x 3/4-inch meter	\$0.10	\$0.10
For 3/4-inch meter	0.10	0.10
For 1-inch meter	0.20	0.20
For 1 1/2-inch meter	--	--
For 2-inch meter	--	--
For 3-inch meter	1.00	1.00
For 4-inch meter	1.00	1.00
For 6-inch meter	1.00	1.00
For 8-inch meter	2.00	2.00
For 10-inch meter	2.00	2.00
Quantity Rate:		
First 300 cu.ft., per 100 cu.ft.	0.015	0.017
Over 300 cu.ft., per 100 cu.ft.	0.020	0.021

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San Jose Water Works
AUTHORIZED INCREASE IN RATES
TO SCHEDULE NO. 6

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rates in effect on that date.

	<u>Rates to be Effective</u>	
	<u>1-1-82</u>	<u>1-1-83</u>
Service Charge:		
For 5/8 x 3/4-inch meter	\$0.10	\$0.10
For 3/4-inch meter	0.10	0.10
For 1-inch meter	0.10	0.10
For 1 1/2-inch meter	0.20	0.20
For 2-inch meter	--	--
For 3-inch meter	--	--
For 4-inch meter	1.00	1.00
For 6-inch meter	1.00	1.00
For 8-inch meter	1.00	2.00
For 10-inch meter	2.00	2.00
Quantity Rate:		
Per 100 cu.ft.	0.012	0.013

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San Jose Water Works

COMPARISON OF MONTHLY RATES

GENERAL METERED SERVICE - SCHEDULE NO. 1

Item	: Current Rates* :	: Proposed Rates :		: Adopted Rates :		
		1981	1982	1981	1982	1983
<u>Service Charge</u>						
For 5/8 x 3/4-inch meter	\$ 2.67	\$ 2.95	\$ 3.05	\$ 2.90	\$ 3.00	\$ 3.10
For 3/4-inch meter	3.47	3.85	4.00	3.70	3.80	3.90
For 1-inch meter	4.43	4.90	5.10	4.80	5.00	5.20
For 1-1/2-inch meter	6.41	7.10	7.35	7.00	7.00	7.00
For 2-inch meter	8.55	9.50	9.85	9.00	9.00	9.00
For 3-inch meter	14.96	17.00	17.75	16.00	17.00	18.00
For 4-inch meter	20.30	23.00	24.00	22.00	23.00	24.00
For 6-inch meter	33.12	37.00	38.50	36.00	37.00	38.00
For 8-inch meter	49.12	55.00	57.00	53.00	55.00	57.00
For 10-inch meter	60.60	68.00	70.50	65.00	67.00	69.00
<u>Quantity Rate</u>						
0-300 cu.ft., per 100 cu.ft.	0.381	0.423	0.438	0.395	0.410	0.427
400-500 cu.ft., per 100 cu.ft.	0.381	0.563	0.584	0.578	0.598	0.619
Over 500 cu.ft., per 100 cu.ft.	0.552	0.563	0.584	0.578	0.598	0.619

The service charge applies to all metered service connections, to it is added the charge for water used during the month at quantity rates.

* General Metered Service Rates authorized by Commission Resolution No. W-2675, effective July 15, 1980.

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San Jose Water Works

COMPARISON OF MONTHLY RATES

GENERAL METERED SERVICE - SCHEDULE NO. 1
(Formerly Schedule No. 1C)

Item	Current Rates*	Proposed Rates		Adopted Rates		
		1981	1982	1981	1982	1983
<u>Service Charge</u>						
For 5/8 x 3/4-inch meter	\$ 2.92	\$ 2.95	\$ 3.05	\$ 2.90	\$ 3.00	\$ 3.10
For 3/4-inch meter	3.50	3.85	4.00	3.70	3.80	3.90
For 1-inch meter	4.80	4.90	5.10	4.80	5.00	5.20
For 1-1/2-inch meter	6.70	7.10	7.35	7.00	7.00	7.00
For 2-inch meter	8.55	9.50	9.85	9.00	9.00	9.00
For 3-inch meter	16.00	17.00	17.75	16.00	17.00	18.00
For 4-inch meter	22.35	23.00	24.00	22.00	23.00	24.00
For 6-inch meter	35.10	37.00	38.50	36.00	37.00	38.00
For 8-inch meter	53.20	55.00	57.00	53.00	55.00	57.00
<u>Quantity Rate</u>						
First 300 cu.ft., per 100 cu.ft.	0.400	0.423	0.438	0.395	0.410	0.427
Over 300 cu.ft., per 100 cu.ft.	0.549	0.563	0.584	0.578	0.598	0.619

The service charge applies to all metered service connections, to it is added the charge for water used during the month at quantity rates.

* Metered Service Rates including Fire Protection Surcharge for customers formerly served by The Campbell Water Company and authorized by Commission Resolution No. W-2676 effective July 15, 1980.

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San Jose Water Works

COMPARISON OF MONTHLY RATES

RESALE SERVICE-NO. 6

Item	:Current Rates*:	:Proposed Rates :		:Adopted Rates :		
		1981	1982	1981	1982	1983
<u>Service Charge</u>						
For 5/8 x 3/4-inch meter	\$ 2.35	\$ 2.95	\$ 3.05	\$ 2.50	\$ 2.60	\$ 2.70
For 3/4-inch meter	2.60	3.85	4.00	2.80	2.90	3.00
For 1-inch meter	3.50	4.90	5.10	3.80	3.90	4.00
For 1-1/2-inch meter	5.00	7.10	7.35	5.00	5.20	5.40
For 2-inch meter	6.40	9.50	9.85	7.00	7.00	7.00
For 3-inch meter	12.00	17.00	17.75	13.00	13.00	13.00
For 4-inch meter	16.00	23.00	24.00	17.00	18.00	19.00
For 6-inch meter	26.00	37.00	38.50	28.00	29.00	30.00
For 8-inch meter	39.00	55.00	57.00	42.00	43.00	45.00
For 10-inch meter	48.00	68.00	70.50	52.00	54.00	56.00
<u>Quantity Rate</u>						
Per 100 cu.ft.	0.323	0.423	0.438	0.348	0.360	0.373

The service charge applies to all metered service connections, to it is added the charge for water used during the month at quantity rates.

* Resale Service Rates authorized by Decision No. 89529, effective November 20, 1980.

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San Jose Water Works
ADOPTED QUANTITIES

Net to gross multiplier	2.0597
Federal Income Tax Rate	46.0%
State Corp. Franchise Tax Rate	9.6%
Local Franchise Tax Rate	0.277%
Uncollectibles	0.267%

<u>Offset Items</u>	<u>Test Years</u>	
	<u>1981</u>	<u>1982</u>
1. <u>Purchased Power:</u>		
Total Production M.G.	59,276,900 Ccf 44,342,200 M.G.	60,401,400 Ccf 45,183,400 M.G.
Electric:		
<u>Pacific Gas and Electric Co.</u>		
Total Cost kWh	\$ 3,060,623 60,291,400	\$ 3,098,564 61,033,900
Eff. Sch. Date \$/kWh Used	Feb. 13, 1980 \$ 0.05076	Feb. 13, 1980 \$ 0.05077
In Effect on ECAC	2/13/80 0.02724 \$/kWh	

	<u>Test Year</u>	
	<u>1981</u>	<u>1982</u>
2. <u>Purchased Water</u>		
<u>Santa Clara Valley Water District</u>		
Quantity (M.G.)	13,502	13,960
Eff. Sch. Date	July 1, 1979	July 1, 1979
\$/M.G.	260.86	260.86
Total Cost (\$1,000)	3,522.1	3,641.6

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San Jose Water Works
ADOPTED QUANTITIES

		<u>Test Year</u>	
		<u>1981</u>	<u>1982</u>
3.	<u>Pump Tax:</u>		
	Eff. Sch. Date	July 1, 1979	July 1, 1979
	\$/M.G.	135.03	135.03
		<u>Test Year</u>	
		<u>1981</u>	<u>1982</u>
4.	<u>Expense Payroll: (\$1,000)</u>		
	Operation & Maintenance	\$ 3,647.0	\$ 3,993.0
	Administrative & General	724.0	793.0
	Total	<u>\$ 4,371.0</u>	<u>\$ 4,786.0</u>
	Expensed Payroll Taxes	\$ 327.3	\$ 355.7
	Composite Payroll Tax Rate	7.49%	7.43%
5.	<u>Employee Benefits: (\$1,000)</u>		
	Pension & Benefits	\$ 981.0	\$ 1,071.6
6.	<u>Ad Valorem Taxes: (\$1,000)</u>		
		<u>1980-81</u>	<u>1981-82</u>
	Tax Rate	4.97%	4.97%
	Assessed Value	\$25,878.5	\$28,282.0
			<u>1982-83</u>
			4.97%
			\$30,793.3

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San Jose Water Works
ADOPTED QUANTITIES

Metered Customers	No.		Usage - Ccf		Avg. Usage - Ccf/Yr.	
	1981	1982	1981	1982	1981	1982
Commercial	186,400	189,800	47,252,400	48,114,300	253.5	253.5
Public Authority	1,165	1,200	3,688,200	3,799,000	3,165.8	3,165.8
Industrial	261	262	2,270,000	2,300,000	8,697.3	8,778.6
Other	301	301	435,000	450,000	-	-
Subtotal	188,127	191,563	53,645,600	54,663,300		
Private Fire Protection	1,280	1,360				
Public Fire Protection	0	0				
Subtotal	1,280	1,360				
Total	189,407	192,923				
Water Loss 9.5%			5,631,300	5,738,100		
Total Water Produced			59,276,900	60,401,400		

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San Jose Water Works
ADOPTED QUANTITIES

Metered Water Sales Used to Design Rates

<u>Meter Size</u>	<u>Metered Service</u>	
	<u>1981</u>	<u>1982</u>
5/8 x 3/4	159,261	162,171
3/4	5,268	5,364
1	17,834	18,160
1 1/2	1,787	1,820
2	2,710	2,759
3	809	824
4	282	287
6	132	287
8	38	134
10	6	6
<u>Total</u>	<u>188,127</u>	<u>191,563</u>

<u>Quantity Blocks (CCF)</u>	<u>Consumption</u>	
	<u>1981 (KCCF)</u>	<u>1982 (KCCF)</u>
0-3	6,252.6	6,367.1
4-5	3,890.9	3,962.3
<u>Over 5</u>	<u>43,502.1</u>	<u>44,333.9</u>
<u>Total</u>	<u>53,645.6</u>	<u>54,663.3</u>

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San Jose Water Works
ADOPTED TAX CALCULATION

Line: No.:	Item	Test Year 1981		Test Year 1982	
		CCFT	FIT	CCFT	FIT
(Dollars in Thousands)					
1	Operating Revenue	\$ 35,807.5	\$ 35,807.5	\$ 37,858.9	\$ 37,858.9
<u>EXPENSES</u>					
2	Operation & Maintenance	16,528.8	16,528.8	17,359.2	17,359.2
3	Administrative & General	2,533.8	2,533.8	2,764.0	2,764.0
4	General Office	0.0	0.0	0.0	0.0
5	Taxes Other	1,701.8	1,701.8	1,852.5	1,852.5
6	CCFT	0.0	778.7	0.0	837.1
7	Subtotal	20,764.4	21,543.1	21,975.7	22,812.8
<u>Deductions from Taxable Income</u>					
8	Tax Depreciation	3,869.7	3,796.8	3,928.9	3,848.5
9	Preferred Stock Tax Credit	0.0	10.4	0.0	10.4
10	Interest	3,061.8	3,061.8	3,234.3	3,234.3
11	Subtotal Deductions	6,931.5	6,869.0	7,163.2	7,093.2
12	Net Taxable Income (CCFT)	8,111.6		8,720.0	
13	CCFT at 9.6%	778.7		837.1	
14	Net Taxable Income (FIT)		7,395.4		7,952.9
15	FIT at 46%		3,401.9		3,658.3
16	Grad. Tax Adj.		(19.2)		(19.2)
17	ITC		(640.9)		(665.7)
18	Net FIT		2,741.8		2,973.4

(Red Figure)

COMMISSIONER JOHN E. BRYSON, DISSENTING:

I would have granted San Jose Water Works a higher return on equity than the 13.3 percent authorized today. San Jose requests in its application a return on equity of 15 percent, while the staff recommends 13.2 percent. In my view the 13.3 percent authorized return does not reflect significant changes in the capital markets which are raising substantially the cost of capital for utilities.

I am concerned that our recent decisions on rate of return do not adequately reflect market conditions. This case provides a good illustration of the problem. Table I presents the trends in long term debt and short term commercial paper over the last decade. Ten years ago, single A bonds sold with a yield of about 8 percent while today long-term bonds are selling for around 15 percent. In 1971, the prime rate was 6 1/2 percent. Today it is near 20 percent. While interest rates have climbed, our return authorizations have been relatively stable. The 13.3 percent authorization today is only slightly higher than our authorization ten years ago, and it is actually lower than current market rates for long and short term debt even though equity is riskier than debt. The market response to such decisions is not surprising. Stock prices have fallen below book value to reflect the fact that utility earnings on book value are below earnings yields for other available investments.


In advocating a higher return my major concern is that insufficiently low return authorizations will ultimately lead to higher rates and lower quality service for customers. Low returns on equity can lead to higher debt costs as bond ratings drop to reflect lower interest coverage ratios. More fundamentally, inadequate returns on equity discourage even

the most necessary capital investments. Equity capital today costs more than the return we are authorizing. It is therefore in the shareholders interest to delay and forgo capital investment whenever possible to avoid earnings loss through dilution.

In arguing for a higher return in this case, I am not recommending such a level of return permanently. Rather, I am advocating return authorizations that reflect market conditions. Should interest rates fall, we should reduce our rate of return authorization accordingly. In today's market, equity returns should be higher.

Our rate of return methodology was developed in an era when inflation was relatively low and interest rates were quite stable. Under the circumstances the methodology worked reasonably well. However, when interest rates fluctuate, it generates untenable results. To arrive at a rate of return in this case, the staff compared the earnings of the company in question with those of other similarly situated companies, and tested the adequacy of various financial ratios. The result of this methodology is basically to ratify previous decisions, since previous decisions determine the earnings of comparable companies. Whatever increase we have authorized has largely been to protect interest coverage ratios which are primarily relevant to debt protection, not to the proper market return on equity. Because our methodology is largely grounded on past decisions, it is not responsive to changes in market conditions that affect the cost of capital. Consequently, we can reach the untenable conclusion that equity return authorizations should actually be less than the returns on less risky debt securities. If interest rates drop in the future, under current methodology, we might authorize returns which are much too high under the market conditions then prevailing.

In light of higher and more volatile interest rates, I request that the Commission staff thoroughly review its rate of return calculation methodology. In making this request, I am not recommending that any particular new method be adopted. I would like the staff to review various alternatives and to fundamentally explore the implications which inflation, risk and fluctuating rates of interest should have on how we determine the rate of return. Whatever method we develop, it should be more grounded on market conditions that is the approach used in this case.



JOHN E. BRYSON, President

San Francisco, California
February 18, 1981

TABLE I

Interest Rate Trends and Commission Decisions
For San Jose Water Works

<u>AA</u>	<u>Bonds</u> ^{1/}	<u>Prime Rate</u> ^{2/}	<u>San Jose Water Works Authorized Return on Equity</u> ^{3/}
1970	8.66	NA	11%
1971	7.49	6½	11
1972	7.11	5	11
1973	7.46	6	11
1974	8.37	9¾	11
1975	9.00	10	12.02
1976	8.95	7½	12.02
1977	8.08	6½	12.02
1978	8.97	8	12.25
1979	9.85	11¾	12.25
1980	12.56	15½	12.25
1981	14.27	20½	13.3

^{1/} Source: Moodies Public Utility Manual, November 1, 1980, page a5. Data for January of the respective years. 1981 is shown for a typical AA utility bond issue in that month.

^{2/} Federal Reserve Bulletins. January high's for each respective year.

^{3/} Decision No. 77766, October 1970; Decision No. 85161, November 1975; Decision No. 89529, October 1978.